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No. 84-498

IN THE

Supreme Court of the United States

October Term, 1984

UNITED STATES OF AMERICA ..... PETITIONER

VS

NATIONAL BANK
OF COMMERCE ....RESPONDENT

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

BRIEF FOR NATIONAL BANK OF COMMERCE

BRIDGES, YOUNG, MATTHEWS,
HOLMES & DRAKE
Attorneys at Law
315 East Eighth Avenue
P. O. Box 7808
Pine Bluff, AR 71611-7808
Telephone No. (501) 534-5532
Attorneys for Respondent

The Perdue Co., Inc., Pine Bluff, Ark.

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SUMMARY OF ARGUMENT

1. The question presented as set out by Petitioner may be restated to ask: Has the IRS demonstrated Respondent is in possession of property or rights to property belonging to the tax debtor as such property or rights to property is defined under Arkansas law? The simple and obvious answer, as found by the District Court and the court of appeals, is that the IRS has not met this burden.

While Roy Reeves did have a right under Arkansas law to make withdrawals from the bank accounts in question, this right, under Arkansas law, does not establish any ownership interests (or "property or rights to property"). Under Arkansas law, the existence of a joint account is not determinative of the ownership interests of the joint depositors and therefore does not determine whether, where a tax debtor is one of the co-depositors, the depository bank has in its possession property or rights to property belonging to the tax debtor.

Specifically, Arkansas law clearly states that ownership interests are not determined or created simply by the existence of a joint account. It is therefore unnecessary to proceed beyond Arkansas law to reach the conclusions reached by the court of appeals, and by simply looking to Arkansas law it is clear that the court of appeals was correct.

Petitioner incorrectly states that Roy had the right to withdraw money from the accounts *and use it to pay his taxes*. However, we only know that he had the right to withdraw the money and do not know whether, even after withdrawal, he would have the right to use it to pay his taxes. This is so because it has not been proven by the IRS that Roy owned the money in the account or had any right to it other than that bestowed by the Arkansas joint account statutes which Arkansas case law conclusively states is not determinative of ownership interests. While as between the bank and Roy, Roy indeed had a right to withdraw the sums, as between Roy and the co-depositors, we do not know whether he had any rights to the money.

While the Petitioner is correct in stating that the court of appeals relied extensively on an Arkansas case involving state garnishment law, it misconstrues the import of the decision relied upon. That decision [*Hayden vs. Gardner*, 238 Ark. 351, 381 S.W.2d 752 (1964)] is not simply a decision setting out the procedures for garnishment under Arkansas law, but in fact reenforces that the existence of a joint account is not determinative of the ownership interests of the respective parties to the account. By pointing out that case, the court of appeals is not as the Petitioner states: ". . . remitting the IRS to only those remedies that an ordinary creditor would have under state law . . .", but is setting out authority for its decision that the IRS has not demonstrated the bank to be in possession of any property or rights to property belonging to Roy.

2. Finally, that the collection of taxes may be made more burdensome by the decision of the court of appeals gives the IRS no authority to exceed that granted it by

Congress. The IRS has the authority only to levy against property or rights to property belonging to the tax debtor. Personal liability can be imposed against someone refusing to honor a levy only if that person is in possession of such property. If the IRS cannot establish that the property or rights to property in question belong to the tax debtor, no personal liability upon the person in possession can be imposed.

ARGUMENT

A. THE BANK HAS NOT BEEN SHOWN TO BE IN POSSESSION OF PROPERTY OR RIGHTS TO PROPERTY BELONGING TO THE TAX DEBTOR.

The court of appeals was correct in determining that the tax debtor's right to withdraw from the joint account does not establish, under Arkansas law, that the bank was in possession of property or rights to property belonging to the tax debtor.

As noted by the Petitioner, the IRS may attempt to collect unpaid taxes under the administrative levy procedure provided in Section 6331(a) of the Internal Revenue Code. The method of instituting that procedure is found in Section 6332(a) which provides for the serving of a notice of levy on any person in possession of property or rights to property belonging to the tax debtor. Upon receipt of such notice, the person in possession of the property or rights to property must then surrender it to the

IRS or be subjected to personal liability under Section 6332(c) (1).

However, as the Petitioner agrees: "'state law controls in determining the nature of the legal interest which the taxpayer [h]as in the property' ". *Aquilino vs. United States*, 363 U.S. 509, 513 (1960) (quoting *Morgan vs. Commissioner*, 309 U.S. 78, 82 (1940)). While the classification of property interests is a federal question, "... the existence of the interests to be federally classified, however, is solely a question of state law." *Fidelity and Deposit Co. vs. New York City Housing Authority*, 241 F.2d 142, 144 (2nd Cir. 1957). That is, if state law, as here, says no property interest exists merely from the fact that an individual is named on a joint account, the inquiry ends and there are no property interests to be federally classified. In this case, state law, alone, creates the legal interests, if any. As noted by Petitioner on page 19 of its brief, " '[O]nce it has been determined that state law creates sufficient interests in the [taxpayer] to satisfy the requirements of the Internal Revenue Code, in short, 'state law is inoperative' and the tax consequences thenceforth are dictated by federal law." [quoting from *United States vs. Bess*, 357 U.S. 51, 56-57 (1958)]. Conversely, when, as here, state law clearly states the existence of a joint account does not create such sufficient interests, the federal tax consequences cannot attach and the search for the existence or nonexistence of sufficient interests must continue and extend beyond simply the surface appearance of the jointly held account. Since, according to *Bess*, the property rights, if any, must be defined by state law, the court of

appeals correctly found it necessary to extensively consider Arkansas law beyond the joint account statutes to determine the applicable law.

Roy's right to withdraw from the joint accounts was established by Ark. Stat. Ann. §67-521 (1980) and Ark. Stat. Ann. §67-552 (1980), amended by 1983 Ark. Acts No. 843, Section 1, which in summary provide that if an account is opened in the name of two or more persons, the bank may pay withdrawal requests upon the direction of any one of the named persons. The Petitioner asks that the Court go no further in its analysis of this case. However, these statutes are clearly not the Arkansas law to which must be referred to determine the nature of Roy's legal interest in the joint accounts. The state law which determines the nature of the legal interest which the taxpayer has in the property must be consulted, and, at least in Arkansas, that state law is a decision of the Arkansas Supreme Court and not the Arkansas Statutes just cited. In *Black vs. Black*, 199 Ark. 609, 135 S.W.2d 837 (1940), the Arkansas Supreme Court found that Ark. Stat. §67-521 was:

> "passed for the protection of the bank in which the deposit was made . . . the statute effects no investiture of title as between the depositors themselves, but only relieves the bank of the responsibility and duty of making inquiry as to the respective interests of the depositors in the deposit until one of the joint tenants shall give notice in writing that the joint ownership has been dissolved."

It is therefore clear that in Arkansas the right to

withdraw sums from a joint account is not alone property or even a right to property. The property interests of the joint account holders must be determined from facts other than only the existence of a joint account. See also, *McGuire vs. Benton State Bank*, 232 Ark. 1008, 342 S.W.2d 79 (1961).

As noted by the court of appeals (Pet. App. 6a-7a):

> Thus, Roy could have withdrawn any amount he wished from the account and used it to pay his debts, including federal income tax, and his co-owners would have had no lawful complaint against the bank, but they might have had a claim against Roy for conversion. The rights of the co-owners *inter sese* are not determined by the cited Arkansas Statutes. Those rights depend on the intention of whoever deposited the money, or on whatever agreement, if any, might have been made among the co-owners, or on some other applicable rule of state law.

This analysis by the court of appeals is exactly accurate. The bank does not know whether Roy has any ownership interest in the account deposits, and the IRS has failed to offer any evidence of that interest. The IRS levy authority extends only to property or rights to property belonging to the tax debtor, and under Section 6332, the bank would be liable in its own person only if it were in possession of property or rights to property belonging to the tax debtor. Since, after referring to state law, the ownership interests in the account deposits have not been

established in this case, there can be no liability of the bank to the IRS.

The IRS, through its levy procedure, does step into the taxpayer's shoes, but at the same time it can stand in no better shoes. *U.S. vs. Sterling National Bank*, 494 F.2d 919 (2nd Cir. 1974). "The IRS acquires by its lien and levy no greater right to property than the taxpayer himself at the time the tax lien arises." *St. Louis Union Trust Co. vs. United States*, 617 F.2d 1293, 1301 (8th Cir. 1980). "[T]he tax collector not only steps into the taxpayer's shoes but must go barefoot if the shoes wear out" or do not exist. 4 Bittker, paragraph 111.5.4 at 111-102.

The Petitioner argues that Roy had the right to withdraw the outstanding balance in the bank accounts and use it to pay his taxes. There is absolutely no proof that Roy had any right whatsoever to use the money on deposit to pay his taxes. That could be determined only by resorting to state law to determine whether Roy actually owned any of the sums on deposit. Roy's right to use the money to pay the taxes would be determined not by his being named on the joint account, but by those factors set out by the court of appeals in its opinion. (See App. Pet. 6a-7a). Since the Petitioner failed to present those factors, it is not known what rights Roy may have had or what shoes, if any exist at all, the IRS may have been able to step into.

Hayden vs. Gardner, 238 Ark. 351, 381 S.W.2d 752 (1964) confirms that under Arkansas law the IRS has failed

to establish whether the account deposits are property or a right to property belonging to Roy. The Petitioner argues that the court of appeals, by its partial reliance upon the *Hayden* case, has left the IRS with only the rights that an ordinary creditor of the taxpayer would have under state law. However, the Petitioner has incorrectly analyzed the *Hayden* decision. That case, while it did indeed deal with the garnishment rights of an ordinary creditor, actually confirms the rule of *Black vs. Black*, and *McGuire vs. Benton State Bank* that the existence of a joint account alone does not determine the respective property rights of the parties to the account or that any party of the account has any interest in the account deposits at all. *Hayden* further confirms that, in this case, the IRS must do something more than simply show that the tax debtor is named on a joint account to prove the existence of property or a right to property belonging to the tax debtor. Since the parties stipulated that no further evidence as to the ownership of the monies in the subject bank accounts would be submitted (J. A. 17), the IRS cannot meet its burden of establishing under state law the nature of the legal interests, if any, Roy has in the subject bank accounts.

Petitioner correctly cites *United States vs. Bess*, 357 U.S. 56 (1958), as meaning that state law restrictions on ordinary creditors are inapplicable to the IRS. However, Petitioner fails to note the obvious distinction between that case and this. In *Bess*, it was undisputed the tax debtor had a right to require payment to herself of the cash surrender value of a life insurance policy. It was also not disputed that she would be the sole owner of the surrender value.

This clearly established the existence of property belonging to the tax debtor under state law even though other New Jersey law exempted the cash surrender value from creditor's liens. Here, no such property right has been, or can be, defined under Arkansas law so that the rule of *Bess* that state law restrictions do not apply to the IRS is irrelevant to this decision.

While the Petitioner notes in its brief (pp. 42-43, note 31), "[I]ronically, if the Eighth Circuit below had strictly followed the rationale of *Hayden*, it would have placed the burden of proof, not on the IRS, but on the bank, which was indirectly asserting Ruby's and Neva's claims. See *Flores vs. United States*, 551 F.2d 1169, 1174 (9th Cir. 1977) . . .", it is interesting to note that the Court in *Flores* placed the burden upon the IRS to demonstrate under state law sufficient facts to indicate the tax debtor had an interest in the account in question. While *Flores* was a wrongful levy case, the burden placement should be the same in this, an action to impose personal liability for denial of a levy. We know, under Arkansas law, to demonstrate a co-depositor has an interest in the joint account, the IRS must do something more than simply show the tax debtor is named on the account. *Black vs. Black, supra*.

Once the court of appeals had correctly determined the appropriate state law applicable to this case, it also correctly found *United States vs. Stockyards Bank of Louisville*, 231 F.2d 628 (6th Cir. 1956) supported its reasoning. Petitioner asserts *Stockyards Bank* involved a

significantly different legal and factual environment than that involved in this case. (App. Brief p. 27, note 22). However, the court of appeals correctly analyzed that the only difference in *Stockyards Bank* and the case at hand is that the property rights in *Stockyards Bank* depended on federal law while here they depend on state law. (App. Pet. 10a). The court of appeals then correctly determined that whether state or federal law must be consulted to determine the property interests is of no consequence and found that if that controlling law, as here, requires something more to determine ownership than simply showing joint title then that additional proof must be submitted before the levy authority can be exercised. The Eighth Circuit's decision is therefore in accord with and supported by that of the Sixth Circuit in *Stockyards Bank*.

The Eighth Circuit also correctly found support for its decision in the dictum of this Court in *United States vs. Rodgers*, 103 S.Ct. 2132 (1983), where this Court said:

> Section 6331, unlike Section 7403 does not require notice and hearing for third parties, because no rights of third parties are intended to be implicated by Section 6331. Indeed third parties whose property or interest in property have been seized inadvertently are entitled to claim that the property has been "wrongfully levied upon," and may apply for its return either through administrative channels, 26 U.S.C. §6343(b), or through a civil action filed in a federal district court, §7426(a) (1); see §7426(b) (1), 7426(b) (2) (A). (Pet. App. 16a).

This Court in the *Rodgers* decision and the Eighth Circuit in the decision below have placed their fingers on the impropriety of using the Section 6331 levy procedure when the property being sought is in a joint bank account and ownership of the balance of the account is not known. The IRS has two available methods to collect its revenues, the Section 6331 levy procedure and the Section 7403 lien procedure. The Petitioner seems to argue that the two statutes are essentially fungible since it argues that the IRS always has the choice of utilizing either of these statutes whenever a taxpayer is delinquent. If this were the case, why would Congress create the two different methods? Why would it not have provided a single levy procedure and required all joint owners to bring an action against the United States for wrongful levy under Section 7426(a) (1)?

The obvious answer is that Congress intentionally devised two procedures: one, the levy procedure, to be used where ownership is not in question, and the other, the lien procedure, where ownership is not known or disputed. This is because, as the Sixth Circuit stated:

> It should be pointed out . . . that distraint is a rough and ready remedy. This shortcut form of self-help developed by the common law has been available to the government and pursued a delinquent taxpayer since the 18th century. Where the value and nature of the taxpayer's property rights are not in question, distraint is no doubt a useful tool in the effective enforcement of the Internal Revenue Laws. But it is a blunt instrument, iladapted to carve out property interests where their nature and extent are unclear.
>
> There is available to the government an alternative remedy well-designed to resolve the issues in the present case. Under Section 3678 of the Internal Revenue Code of 1939, the United States can bring suit against the bank to enforce a lien on the bonds and name both the taxpayer and his wife co-defendants. In such a proceeding the extent of the taxpayer's interest in the bonds can be finally adjudicated, and the rights of all parties fully protected. *United States vs. Stockyards Bank of Louisville*, 231 F.2d 628, 631-32 (6th Cir. 1956).

B. THE SUPPOSED THREAT OF THE COURT OF APPEAL'S DECISION TO THE FEDERAL TAX COLLECTION PROCESS DOES NOT JUSTIFY ALLOWING THE IRS TO EXCEED ITS GRANTED AUTHORITY.

The Petitioner argues that ". . . the Eighth Circuit's ruling would effectively preclude administrative levies whenever a taxpayer's property is titled in joint names." (Pet. Brief p. 40). Petitioner argues that administrative levies would be thwarted because taxpayers across the country would place their accounts in joint names and effectively prohibit the IRS from exercising its levy authority.However, this potential difficulty does not justify the IRS in seizing through the levy procedure, property or rights to property not belonging to the tax debtor. Congress

has given it the authority only to levy on property or rights to property belonging to the tax debtor, and to allow the IRS to levy upon property which, under state law, has not been demonstrated to belong to the tax debtor would be to allow the IRS to exceed its statutory authority.

This horrific potential is no greater than the possibility that all tax debtors might create an alter ego to hold their property or place the property entirely in the possession of a straw man or nominee. The IRS has successfully combated such tactics to avoid tax liability. See *DiEdwardo vs. First National Bank*, 442 F.Supp. 499 (E.D. Tenn. 1977) and *Valley Finance, Inc. vs. United States*, 629 F.Supp. 162 (D.C. Cir. 1980).

Instead of disabling the IRS's tax collection activities, affirmance of the Eighth Circuit's decision would provide innocent co-depositors (at least in Arkansas) with protection against unauthorized seizure by the IRS of their money and would protect banks (again, at least in Arkansas) from having to independently adjudicate the rights of co-depositors in the account in their hands and from the potential liability they might face if they make an incorrect adjudication.

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

Mr. Terry F. Wynne
BRIDGES, YOUNG, MATTHEWS,
HOLMES & DRAKE
P. O. Box 7808
Pine Bluff, Arkansas 71611
Telephone No. (501) 534-5532
Attorneys for National Bank
of Commerce